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No. 144

IN THE

Supreme Court of the United States

OCTOBER TERM, [redacted] 1958

FORD MOTOR COMPANY, *Petitioner*,

v.

THE UNITED STATES

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

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THE UNITED STATES

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

Petitioner prays that a Writ of Certiorari be issued to review the judgment of the Court of Claims in the above entitled case.

OPINION BELOW

The opinion of the Court of Claims (R. 77) is reported at Ct. Cl. , 156 F. Supp. 554. (Appendix B).

JURISDICTION

The judgment of the Court of Claims sought to be reviewed was entered on December 4, 1957. (R. 77) Within the period of time extended for that purpose by the Court of Claims by order dated January 8, 1958, petitioner filed a timely petition for rehearing which was denied by order of the Court of Claims

entered on April 2, 1958. (R. 79) Jurisdiction of this Court is invoked under 28 U.S.C., Section 1255(1).

QUESTIONS PRESENTED

Petitioner claims refund of that portion of the manufacturers excise tax paid on sales of automotive vehicles, parts and accessories which is proportionate to rebates made to purchasers on account of defects in materials or workmanship between August 1, 1949 and December 31, 1954.

The questions presented are:

1. Whether cash payments or cash credits made or allowed by a manufacturer to its vendees, pursuant to an express warranty in respect of defects discovered within the warranty period are price readjustments by "rebate or allowance" within Section 3443(a)(2) of the Internal Revenue Code of 1939 and Section 6416(b)(1) of the Internal Revenue Code of 1954.

2. Whether cash payments or cash credits made or allowed by a manufacturer to its vendees pursuant to its practice or policy of adjustment, in respect of defects discovered within or beyond the warranty period, are price readjustments by "rebate or allowance" within Section 3443(a)(2) of the Internal Revenue Code of 1939 and Section 6416(b)(1) of the Internal Revenue Code of 1954.

STATUTES AND REGULATIONS INVOLVED

Internal Revenue Code of 1939:

SEC. 3403. TAX ON AUTOMOBILES, ETC.

There shall be imposed upon the following articles sold by the manufacturer, producer, or im-

porter, a tax equivalent to the following percentages of the price for which so sold:

(a) Automobile truck chassis, automobile truck bodies, automobile bus chassis, * * * tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer (including in each of the above cases parts or accessories therefor sold on or in connection therewith or with the sale thereof), 8 per centum,[1] * * *.

(b) OTHER CHASSIS AND BODIES, ETC.—Other automobile chassis and bodies, * * * (including in each case parts or accessories therefor sold on or in connection therewith or with the sale thereof), except tractors, 10 per centum,[2] * * *.

(c) Parts or accessories * * * for any of the articles enumerated in subsection (a) or (b), 8 per centum,[1] * * *.

(26 U.S.C. 1952 ed., Sec. 3403.)

SEC. 3441. SALE PRICE.

(a) In determining, for the purposes of this chapter, the price for which an article is sold, there shall be included any charge for coverings and containers of whatever nature, and any charge incident to placing the article in condition packed ready for shipment, but there shall be excluded the amount of tax imposed by this chapter, whether or not stated as a separate charge. A transportation, delivery, insurance, installation, or other charge (not required by the foregoing sentence to be included) shall be excluded from the price only if the amount thereof is established to

[1] 5 per centum prior to Nov. 1, 1951.

[2] 7 per centum prior to Nov. 1, 1951.

the satisfaction of the Commissioner, in accordance with the regulations.

(b) If an article is—

(1) sold at retail;

(2) sold on consignment; or

(3) sold (otherwise than through an arm's length transaction) at less than the fair market price;

the tax under this chapter shall (if based on the price for which the article is sold) be computed on the price for which such articles are sold, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Commissioner.

* * * * * * * * * *

(26 U.S.C. 1952 ed., Sec. 3441.)

SEC. 3443. CREDITS AND REFUNDS.

(a) A credit against tax under this chapter, or a refund, may be allowed or made—

* * * * * * * * * *

(2) to any person who has paid tax under this chapter with respect to an article, when the price on which the tax was based is readjusted by reason of return or repossession of the article or a covering or container, or by a bona fide discount, rebate, or allowance; in the amount of that part of the tax proportionate to the part of the price which is refunded or credited.

* * * * * * * * * *

(26 U.S.C. 1952 ed., Sec. 3443.)

The corresponding provisions of the Internal Revenue Code of 1954 are essentially the same. They are set forth in Appendix A.

Pertinent regulations are set forth in Appendix A.

STATEMENT

The petitioner is a manufacturer of passenger automobiles and trucks, and parts and accessories therefor, and sells such products to its authorized dealers, who are not the agents of the petitioner but who purchase for resale as principals.

In connection with sales of its products, petitioner, by written instrument given to its vendees, expressly warranted its products to be free from defects in material and workmanship for the period prior to either (1) the time such product had been driven, used or operated for a distance of 4,000 miles, or (2) 90 days from the date of delivery of such product to the original retail purchaser thereof, whichever event first occurred. (Pet., par. 5, R. 2).

In addition to the express warranty, it was petitioner's policy, under certain circumstances, to pay to its vendees the cost of repair or replacement of its products found to be defective both within and beyond the periods stated in the express warranty. (Pet., par. 6, R. 2).

No extra charge was made for the express warranty or costs to be incurred under petitioner's policy. Instead, the sales prices included a charge in respect of adjustments to be made pursuant to the warranty or pursuant to petitioner's policy. (Pet., par. 7, R. 2).

Sales prices of petitioner's products, on which petitioner paid manufacturers excise taxes, were readjusted during the periods in suit by cash payments made or cash credits allowed to its vendees pursuant to said warranty and pursuant to said policy. (Pet., par. 8(a), R. 63).

The petitioner brought suit in the Court of Claims under 28 U.S.C., Section 1491, claiming refunds aggregating $8,899,547.53, on the ground that the cash payments made, and cash credits allowed to its vendees were price readjustments by "rebate or allowance" for which a proportionate tax credit or refund is allowable under Section 3443(a)(2) of the Internal Revenue Code of 1939 and under Section 6416(b)(1) of the Internal Revenue Code of 1954.

REASONS FOR GRANTING THE WRIT

1. The Court of Claims has decided an important question of federal law which has not been, but should be, settled by this Court for the guidance of manufacturers generally and for orderly administration of the Statute.

The question presented is one of importance generally to manufacturers subject to the Federal Manufacturers Excise Tax. At least twenty-four suits are now pending in the Court of Claims or in Federal District Courts involving the question of excise tax refunds in connection with manufacturers' warranties.

Every manufacturer has the problem of arranging its program for handling possible defects in its products. Certainty in the application of the sections of the statute here involved is necessary to enable programming in terms of predictable tax consequences. But such programming is not now possible for lack of a precise and authoritative interpretation of the taxing and refund provisions of the statute.

The refund provisions of the statute seem clearly to cover price readjustments on account of warranted defects whether effected by reason of *either* (a) re-

turn of the defective article *or* (b) rebate or allowance paid or credited to the purchaser without return of the article.

Confusion as to the precise application of the refund provision arises, however, by reason of the recent conflicting Court of Claims decisions.

In a series of recent *Frigidaire* cases, the Court of Claims (1) first recognized that expenditures to remedy a defect were an "allowance" within the refund provision; then (2) repudiated the "allowance" concept, but (3) ruled that alternative relief might be had in the case of an extraordinary warranty beyond the customary period by way of an "exclusion" from the taxable price of the cost of such extra warranty where a separate charge had been made to the vendee for such a warranty. Apparently no relief was recognized in respect of a customary warranty for the usual period.

In the *Ford* decision, for which review is here sought, the "allowance" concept was rejected for reasons which seem both unsound and without support in the statute.

Authoritative ruling by this Court on the questions here presented is required to clarify the controlling principles for the guidance of manufacturers and for orderly administration of the excise tax.

2. Confusion confronts manufacturers as a result of the four recent Court of Claims decisions.

The first three decisions each involved the Frigidaire Division of General Motors. The fourth is the *Ford* decision for which review is here sought.

The *Frigidaire* cases involved two express warranties: A one year warranty, and a five year warranty.

The first and second cases dealt with the five year warranty, the $5.00 cost of which was separately stated in the price the vendee was required to pay. Plaintiff sought refund on alternative grounds: (1) As an "allowance" [under Internal Revenue Code of 1939, Sec. 3443(a)(2)] for the cost of fulfilling the five year warranty; or (2) on the basis of "exclusion" from the purchase price [under Internal Revenue Code of 1939, Sec. 3441] of the extra $5.00 charge for the warranty. The Court recognized the "allowance", but rejected the "exclusion."

Relying on the first and second cases, plaintiff in the third *Frigidaire* case sought refund of excise tax proportionate to its costs in respect of the one year warranty as well as its costs in respect of the five year warranty. But the Court rejected "allowance" as to either warranty, and instead recognized "exclusion" with respect to the extra charge for the five year warranty.

One may surmise that the Court felt impelled to grant some relief with respect to the five year warranty, but was beset with the problem of doing it on some basis which would not include the one-year warranty. This led to unsound distinctions which leave in doubt the circumstances of availability of both "allowance" and "exclusion."

The distinctions drawn between the one year and five year warranties for the purpose of differentiating their treatment are without substance.

The first distinction was on the basis of the $5.00 extra charge which the Court held invoked the "exclusion" theory. But the "exclusion" from price was permitted subject to the limitation that only that part

of the $5.00 which bears "a close relationship to the actual cost of rendering the [warranty] service" (*General Motors* v. *United States*, Ct. Cl. , 147 F. Supp. 739, 740 (1957)) can be recognized as an "exclusion" from the price. As pointed out in the dissent, however, under the "exclusion" theory, the entire $5.00 would have to be excluded as the price received for a non-taxable item—the warranty contract. Clearly, when the "exclusion" is based not upon non-taxable price, but instead on subsequent cost of rendering the warranty service, the principle really involved is "allowance" which, being based on actual cost, is obviously as applicable to the one year warranty as to the five year warranty. Thus this distinction relied on to deny refund in respect of cost of fulfilling the one year warranty is without substance.

The second distinction was that the one year warranty is customary in the trade and thus analogous to an implied warranty and therefore different from the five year extra warranty. The concept apparently is that the implied warranty is, as a matter of law, inseparable from the article sold, so that the purchaser receiving the benefits thereof is simply enjoying a built-in feature of the article bought.

But the analogy is invalid. Express warranties derive solely from a special agreement, which may specifically exclude the implied warranty otherwise inhering in the article. There is no necessary relationship between the scope and duration of an express warranty, whether or not customary, and the warranty otherwise implied by law. This was pointed out by Judge Madden in the first *Frigidaire* case, [128 Ct. Cl. 465, 467-8, 121 F. Supp. 932, 933-4 (1954)]

with specific reference to the one year express warranty there involved. There was thus no sound basis in that case for treating the customary one year express warranty differently from the five year warranty on the theory that the one year warranty was analogous to an implied warranty.

Furthermore, according more favorable treatment to a five year warranty, on the ground that it is not customary, is an unsound basis for distinction because the unusual warranty may well become customary by reason of its advantageous tax consequences.

The development of the present confusion in the law is easily traced.

In the first *Frigidaire* case [128 Ct. Cl. 465, 121 F. Supp. 932, cert. denied 348 U.S. 942 (1955)]:

> (a) The Court indicated that there is no material distinction between the two express warranties: the customary express warranty for a one year period, and the express warranty for a longer period of five years.
>
> (b) The Court held that the costs of fulfilling the five year warranty constituted readjustments of price by means of an "allowance" within the meaning of the statute.

On the latter point, the Court said (121 F. Supp. 935):

> "* * * When an article is sold with a warranty, and fulfillment of the warranty costs the seller a certain sum, he has in fact received for the article only the amount by which the sale price exceeded the cost of fulfilling the warranty. He

has, in effect, given the purchaser an 'allowance' when he has spent money for his benefit. * * *".

The second *Frigidaire* case [*General Motors* v. *United States*, Ct. Cl. , 146 F. Supp. 220 (1956)] reaffirmed the holding in the first case.

The third *Frigidaire* case [*General Motors* v. *United States*, Ct. Cl. —, 147 F. Supp. 739 (1957)], however, repudiated the views expressed in the first case:

(a) A distinction was taken between an express warranty for the customary one year period, and an express warranty for a five year period; the one year warranty was analogized to an implied warranty whereas the five year warranty was not.

(b) Because there was an "extra charge"—which "was not a part of the sales price"—for the five year warranty, the Court decided that "exclusion" from the sales price, rather than "allowance," was the appropriate relief.

(c) It was held that no "allowance" was available in respect of the one year warranty because it was analogous to an implied warranty, and because there was no "extra charge" for the one year warranty.

(d) Presumably, "exclusion" was not available with respect to the one year warranty either because no "extra charge" was made for it, or because it was analogized to an implied warranty, or because of both reasons.

In the fourth decision—the *Ford* case, for which review is sought—the Court of Claims, indicated a view apparently different from that expressed in the third *Frigidaire* case:

(a) It held that there was no distinction between Ford's express warranty for the customary period and its policy beyond such period.

(b) It analogized (necessarily by implication) not only the customary warranty, but also the extra policy, to an implied warranty.

Since all express warranties appear now to be in the category of implied warranties—for which the Court of Claims has denied "allowance"—it is not clear just what a manufacturer must do to avail himself of the "allowance" provision of the statute.

Moreover, a reading of the *Ford* decision together with the third *Frigidaire* case suggests the likelihood that the "exclusion" permitted in the latter case may no longer be available. While *Frigidaire* permitted "exclusion" for an extra warranty, for which there was an extra charge, "exclusion" was presumably denied for the customary warranty for lack of an "extra charge," and because analogized to an implied warranty. But, under the *Ford* decision, apparently all warranties, adjustment policies or practices are now to be treated as implied warranties—at least where there is no separately stated "extra charge."

Thus, the "extra charge" appears to be the only basis left for granting an "exclusion." But this would not appear to be a tenable basis for determination of important tax consequences. Mere separate statement to the purchaser of "extra charge" for the warranty

is clearly a meaningless formality not supported by the statute. The only ground for an "exclusion" is the "other charge" provision in the statutory definition of price [Internal Revenue Code of 1939, Sec. 3441(a)] which turns not upon separate statement, but rather upon whether the amount thereof is satisfactorily established.

We are therefore left by the cases without any satisfactory criterion to guide a manufacturer in programming for an "exclusion" if indeed that remains available.

Thus, these Court of Claims decisions have not only left the availability of "allowances" generally in doubt, but have added to the confusion by leaving uncertain the availability of "exclusion" as an alternative to "allowance."

3. The *Ford* decision requires clarification for the further reason that it is uncertain whether it rests upon facts in the petition or is limited to the facts assumed in the opinion.

It is error for a court to grant judgment for the defendant on the pleadings unless, as a matter of law, no facts could be proved under the allegations to sustain recovery. *Michel* v. *Meier*, 8 F.R.D. 464, 470 (W.D. Pa. 1948). In view of this, the *Ford* decision might be taken as purporting to be applicable to every state of facts provable under the allegations.

But the rulings in the *Ford* decision appear to be addressed only to specific *assumed* facts, for the pur-

Sales prices of petitioner's products include a charge for the warranty and its policy. Pet. par. 7, R. 2, which is not separately stated.

pose of bringing the case within the ambit of the third *Frigidaire* case, instead of being based on the materially different facts stated in, and provable under, the allegations in the *Ford* petition. One example will suffice to illustrate this point.

The petition alleges (par. 6, R. 2) that, "in addition to the express warranty, * * * it was the established policy of plaintiff, as set forth in certain written communications to its authorized dealers, to repair or replace or bear the cost of the repair or replacement" of items found to be defective, but not covered by the express warranty. Under these allegations, it is open to the petitioner to prove the voluntary character of the benefits accorded under the policy as distinguished from the contractual obligation of the express warranty. Thus, benefits which might be received by the vendee under such a policy are in addition to what a purchaser "contracted to buy" or had a right to receive.

But in the *Ford* decision, the Court of Claims assumed that the policy was contractual, not voluntary, and thus did not differ from the express warranty. The Court said (Appendix B, infra, p. 5a; R. 78):

> "* * * [Company expenditures under the policy] were made in a liberal interpretation of the *obligation* of the seller to deliver a sound article, as an *agreed* extension of its *obligation* under the warranty. That the defect appeared after the *warranty* period, strictly construed, makes no difference. The expenditures were still made to give the purchaser what he had *contracted* to buy, and in accordance with the seller's policy of which the purchaser had been informed before the sale * * *." (Emphasis added.)

In the context of this case—where petitioner was not permitted to prove the voluntary character of its policy—does the foregoing ruling preclude "allowance" in respect of gratuitous adjustments, i.e. after the warranty period, or is the ruling restricted by its phraseology to contractual adjustments in order "to give the purchaser what he contracted to buy?"

4. The decision below is erroneous and should be reviewed by this Court.

Under the statute, the tax is imposed upon "articles sold by the manufacturer" (Internal Revenue Code of 1939, Sec. 3403). The measure of the tax is the price for which the article is sold which, presumably, is its fair value. Thus, under specified circumstances where articles are sold otherwise than at fair value, provision is made (Internal Revenue Code of 1939, Sec. 3441(b)) for tax on the basis of such fair value rather than the price of the particular sale.

As stated in the *Ford* decision (Appendix B, infra, p. 5a; R. 78), "The sales price was for an article free of defects." Logically, the fair value of a defective article would be less than the sales price for an article free of defects. It is accordingly entirely consistent with the policy of the statute that the tax on a defective article should be less than the tax in respect of an article free of defects. Thus, if the price of an article is readjusted in order to reflect the lower value by reason of a defect, a proportionate part of the tax paid on the original price should be refunded.

The statute provides generally for proportionate refund of the tax when the price on which the tax is based is readjusted by either return of the articles or by rebate or allowance.

It is unsound for the Court of Claims to argue that adjustments pursuant to an express warranty are not price readjustments entitling a manufacturer to a refund on the ground that the vendee had neither gained nor lost but had only received that for which he contracted.

Under the general law, it is competent for the manufacturer to agree with the purchaser upon the terms of an express warranty to the exclusion of any implied warranty. Consistent with the above indicated provisions and policy of the statute, it is competent for them also expressly to provide that, in the event of discovery of a defect within a stated period, there shall be a readjustment of the price (on which the tax is based) and that such readjustment may be made by cash payments or cash credits.

Readjustment of price pursuant to any such contract is a recognition that the article actually sold had a fair value less than the price paid, and that the amount of the readjustment so made merely reflects the difference in value. The net result is precisely the same whether the express warranty is phrased in terms of price readjustment or simply in terms of replacement, repair or cash credits.

The Regulations recognize that price reductions by way of rebates may be made pursuant to contract, as, for example, where the sale agreement provides for a rebate in the event of a price reduction by the manufacturer applicable to articles remaining unsold in the hands of the dealer (Regulations 46, Sec. 316.13(c)). Obviously the whole purpose of any such contract, like the express warranty, is to avoid gain or loss on the part of the purchaser by reason of the

event with respect to which the stipulation is addressed. It is therefore unsound to argue, as the Court did in the *Ford* decision, that adjustments made pursuant to an express warranty are not readjustments of the sales price pursuant to contract because the purchaser neither gained nor lost anything by fulfillment of the contract or obligation.

Actually, however, the position of each party is changed by reason of any readjustment of the price pursuant to contract. To use a warranty contract for example, suppose that a manufacturer sells for $2,000 a car which has a defect which requires the expenditure of $200 to correct. Presumably, the fair value of the defective car as sold is $1,800. If the manufacturer makes a refund of $200 on account of the purchase price, the purchaser has in effect received a price readjustment reflecting the true value of the article which he actually purchased.

It would be possible for the manufacturer to exclude by contract all warranty liability. Therefore, except for the provision of the express warranty, the purchaser (1) would have a defective article for which he paid $2,000, and (2) would be obliged to expend an additional $200 out of his own pocket in order to correct the defect. But by reason of the express warranty, the $200 required to correct the defect is paid or credited to him. Not having to expend $200 out of his own money to correct the defect, he has by virtue of the express warranty in effect received a readjustment in price for the defective article in the amount of $200. The manufacturer, on the other hand, has in effect received only $1,800 the fair value—of the defective article which he sold.

Excise tax was paid on the basis of a value of $2,000. By virtue of the payment under the express warranty, there has been a "rebate" of $200 for which the manufacturer is entitled to a proportionate excise tax refund or credit under the statute.

The Court was, of course, in error in viewing the *Frigidaire* case as controlling here. The facts are quite different.

In *Frigidaire*, there was no readjustment in the price paid to the manufacturer by its vendee. This is evident in two respects: (1) The manufacturer itself directly repaired defective parts in the hands of ultimate consumers. The transaction in no way affected or concerned the manufacturer's vendee from whom it received the purchase price which was taxed. Thus, the Regulations (Regulations 46, Sec. 316.13), dealing with "discounts and adjustments generally" precluded any rebate:

> "(d) * * * allowances, payments or adjustments made to persons other than the manufacturer's vendee are not deductible from the sales price under any conditions for purposes of computing the tax."

(2) The manufacturer replaced in kind and made no cash credit or rebate to anyone. The *Frigidaire* case is thus clearly outside the wording of the refund section of the statute.

But in the *Ford* case, (1) the manufacturer dealt exclusively with its vendee who paid the purchase price taxed and who received the "rebate," and (2) the manufacturer made adjustments only by way of cash payments and credits as distinguished from re-

placements in kind. Thus, on the facts, the *Ford* case is clearly distinguishable from the *Frigidaire* case.

CONCLUSION

For the foregoing reasons, it is respectfully submitted that this petition for a writ of certiorari should be granted.

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June 30, 1958

APPENDIX A

Pertinent Provisions of the Internal Revenue Code of 1954

CHAPTER 32—MANUFACTURERS EXCISE TAX.

SEC. 4061. IMPOSITION OF TAX.

(a) AUTOMOBILES.—There is hereby imposed upon the following articles (including in each case parts or accessories therefor sold on or in connection therewith or with the sale thereof) sold by the manufacturer, producer, or importer a tax equivalent to the specified percent of the price for which so sold:

(1) Articles taxable at 8 percent. * * *

Automobile truck chassis.

Automobile truck bodies.

Automobile bus chassis.

* * * * * * * * *

Tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer.

* * * * * * * * *

(2) Articles taxable at 10 percent * * *

Automobile chassis and bodies other than those taxable under paragraph (1).

* * * * * * * * *

(b) PARTS AND ACCESSORIES.—There is hereby imposed upon parts or accessories * * * for any of the articles enumerated in subsection (a) sold by the manufacturer, producer, or importer a tax equivalent to 8 percent of the price for which so sold, * * *.

(26 U.S.C. 1952 ed., Supp. II, Sec. 4061).

SEC. 4216. DEFINITION OF PRICE.

(a) CONTAINERS, PACKING AND TRANSPORTATION CHARGES.—In determining * * * the price for which an article is sold, there shall be included any charge

for coverings and containers * * *, and any charge incident to placing the article in condition packed ready for shipment, but there shall be excluded the amount of tax imposed by this chapter, whether or not stated as a separate charge. A transportation, delivery, insurance, installation, or other charge (not required by the foregoing sentence to be included) shall be excluded from the price only if the amount thereof is established to the satisfaction of the Secretary or his delegate in accordance with the regulations.

(b) CONSTRUCTIVE SALE PRICE.—If an article is—

(1) sold at retail,

(2) sold on consignment, or

(3) sold (otherwise than through an arm's length transaction) at less than the fair market price,

the tax under this chapter shall (if based on the price for which the article is sold) be computed on the price for which such articles are sold, in the ordinary course of trade, by manufacturers or producers thereof, as determined by the Secretary or his delegate.

* * * * * * * * * * *

(26 U.S.C. 1952 ed., Supp. II, Sec. 4216).

SEC. 6416. CERTAIN TAXES ON SALES AND SERVICES.

* * * * * * * * * * *

(b) SPECIAL CASES IN WHICH TAX PAYMENTS CONSIDERED OVERPAYMENTS.—Under regulations prescribed by the Secretary or his delegate credit or refund, without interest, shall be made of the overpayments determined under the following paragraphs:

(1) PRICE READJUSTMENTS.—If the price of any article in respect of which a tax, based on such price, is imposed by chapter 31 or 32, is readjusted by reason of the return or repossession of the article

or a covering or container, or by a bona fide discount, rebate or allowance, the part of the tax proportionate to the part of the price repaid or credited to the purchaser shall be deemed to be an overpayment.

* * * * * * * * *

(26 U.S.C. 1952 ed., Supp. II, Sec. 6416).

Pertinent Regulations

Regulations 46, Sec. 316.13 Discounts and adjustments, generally.

(a) Readjustments in sale price (such as allowable discounts, rebates, bonuses, etc.) can not be anticipated. * * * However, if the price upon which the tax was computed is subsequently readjusted, a proper credit may be taken against the tax due on a subsequent return, or an appropriate claim for refund may be filed. * * *

(b) Where articles are sold over a period of time under an agreement for a quantity rebate, or an agreement for a so-called wholesale bonus, and an adjustment in price is actually allowed in accordance with such agreement, the tax may be adjusted in the return for the month in which the price is finally determined, or a claim for refund may be filed. * * *

(c) Where articles are sold under an agreement which provides for a rebate in the case of a price reduction applicable to articles remaining unsold in the hands of a dealer, and a rebate is made in accordance with such agreement, a corresponding adjustment of tax paid may be effected through a credit or claim for refund. * * *

(d) * * * allowances, payments or adjustments made to persons other than the manufacturer's vendee are not deductible from the sale price under any conditions for purposes of computing the tax.

APPENDIX B

FORD MOTOR COMPANY

v.

THE UNITED STATES

156 F. Supp. 554

(December 4, 1957)

ON DEFENDANT'S MOTION FOR JUDGMENT ON THE PLEADINGS

WHITAKER, *Judge*, delivered the opinion of the court:

Plaintiff sues to recover excise taxes on amounts expended by it to discharge its obligation under its established policy and under its ninety-day warranty on automobiles sold by it to its dealers. Ninety days is the warranty period customary in the trade. We think its case is ruled by our decision in *General Motors* v. *United States*, No. 55-56, decided January 16, 1957.

1. The distinction plaintiff seeks to draw, that in the *General Motors* case the sale was to the consumer whereas in the present case it was to the dealer, is without merit. In both cases the manufacturer gave to its purchaser, in one case, the consumer, and in the other, the dealer, a warranty that it was selling him a sound article; hence, sums spent to remedy any defect appearing in the warranty period were spent to make good the manufacturer's representation that the article sold was free of defects, and therefore the sums spent were not a readjustment of the sales price or a rebate or allowance.

In the *General Motors* case, *supra*, the seller made the necessary repairs; in the present case, the purchaser did so, and then was reimbursed by the manufacturer. In each case, the expenditure by the manufacturer was for correcting a defect. It was not a readjustment of the sales price.

The sales price was for an article free of defects. The sums spent for correcting defects were to fulfill the seller's part of the bargain, to deliver a sound article.

It makes no difference that the defect appeared after the dealer had resold the article. Under his contract of resale, he was obligated to his purchaser to make good any defects appearing in a certain period, and the manufacturer was in turn liable to the dealer to make them good. The dealer, who was the purchaser from the manufacturer, neither lost anything nor gained anything on account of remedying the defects. Therefore, there could not have been a rebate or allowance to him.

2. Plaintiff devotes one paragraph of its brief to expenditures made to remedy defects discovered after the warranty period, in accordance with the seller's established policy as set forth in written communications from the seller to the purchaser. The character of these expenditures does not differ from the others. They were made in a liberal interpretation of the obligation of the seller to deliver a sound article, as an agreed extension of its obligation under the warranty. That the defect appeared after the warranty period, strictly construed, makes no difference. The expenditures were still made to give the purchaser what he had contracted to buy, and in accordance with the seller's policy of which the purchaser had been informed before the sale. After the expenditures were made, the contractor got no more than he had paid for, to wit, a sound article; he certainly did not get back any part of the purchase price.

Defendant's motion for judgment on the pleadings is granted, and plaintiff's petition is dismissed.

It is so ordered.

FAHY, *Circuit Judge*, sitting by designation; LITTLETON, *Judge*; and JONES, *Chief Judge*, concur.

MADDEN, *Judge*, concurs in the result.

UNITED STATES COURT OF CLAIMS

No. 231-56

FORD MOTOR CO.

vs.

THE UNITED STATES

Clerk's Office
Washington, D. C., Jan. 8, 1958

To Attorney of Record and Assistant Attorney General, and Commissioner

Sirs:

Please take notice that in the above-entitled cause there has been entered this day on the plaintiff's motion for extension of time for filing motion for rehearing the following order: Allowed

Respectfully,

WILLARD L. HART
Clerk, Court of Claims.

IN THE UNITED STATES COURT OF CLAIMS

No. 231-56

FORD MOTOR CO.

v.

THE UNITED STATES

Order

This case comes before the court on plaintiff's motion, filed February 3, 1958, for rehearing and to vacate the judgment of dismissal entered December 4, 1957, together with defendant's response thereto. Upon consideration thereof,

IT IS ORDERED this second day of April, 1958, that plaintiff's motion for rehearing and to vacate the judgment of dismissal be and the same is denied.

BY THE COURT

MARVIN JONES,
Chief Judge.

FILE COPY

Office - Supreme Court, U.S.
FILED
JUL 28 1958
JOHN T. FEY, Clerk

No. 144

In the Supreme Court of the United States

OCTOBER TERM, 1958

FORD MOTOR COMPANY, PETITIONER

v.

UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

J. LEE RANKIN,
Solicitor General,
CHARLES K. RICE,
Assistant Attorney General,
HARRY BAUM,
MYRON C. BAUM,
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Department of Justice,
Washington 25, D. C.

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In the Supreme Court of the United States

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FORD MOTOR COMPANY, PETITIONER

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UNITED STATES OF AMERICA

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF CLAIMS

BRIEF FOR THE UNITED STATES IN OPPOSITION

OPINION BELOW

The opinion of the Court of Claims (Pet. App. 1a-5a) is reported at 156 F. Supp. 554.

JURISDICTION

The judgment of the Court of Claims was entered on December 4, 1957. (Pet. App. 4a-5a; R. 77-78.) A timely petition for rehearing was denied on April 2, 1958. (Pet. App. 7a.) The petition for a writ of certiorari was filed June 30, 1958. Jurisdiction of this Court is invoked under 28 U.S.C., Section 1255.

QUESTION PRESENTED

Whether taxpayer, an automobile manufacturer which incurred costs in fulfilling an express warranty of its products against defects, is entitled, under provisions of the Internal Revenue Code, to a refund, *pro tanto*, of the manufacturer's excise tax paid upon the sale of such products.

STATUTES AND REGULATIONS INVOLVED

Sections 3403, 3441(a), 3443(a)(2) and (b) of the Internal Revenue Code of 1939, Section 6416(b)(1) of the Internal Revenue Code of 1954, and Sections 316.12, 316.13, and 316.14 of Treasury Regulations 46 are set forth in pertinent part in Appendix A, *infra*, pp. 11-15.

STATEMENT

This action involves claims for refund of manufacturer's excise taxes. Taxpayer is a manufacturer of passenger automobiles and trucks, and parts and accessories therefor, and sells its products to authorized dealers who in turn resell them to retail purchasers. (R. 1-2) By written instruments delivered to its authorized dealers, taxpayer expressly warranted the material and workmanship of the products against defects manifesting themselves prior to either (1) the time such products had been driven, used or operated for a distance of 4,000 miles or (2) 90 days from the time of delivery of such product to the original retail purchaser thereof (whichever event first occurred). The dealers delivered similar written warranties to the original retail purchasers. It was also taxpayer's policy, under certain conditions, to repair or replace (or bear the cost of repairing or replacing) products even after expiration of the period described in the

express warranty. No extra charge was made for the warranty, or for costs that might be incurred under taxpayer's repair and replacement policy. (R. 2.)

Between August 1, 1949, and December 31, 1954, taxpayer incurred certain costs in fulfilling warranties of its products and in carrying out its repair and replacement policy.[1]

It thereafter filed claims for refund of that portion of the manufacturer's excise taxes paid which corresponded to the proportion which the costs incurred by it bore to the original sale price. These claims for refund totaled $8,899,547.53. No action having been taken on such claims by the Commissioner, taxpayer instituted suit for refund in the Court of Claims under 28 U. S. C., Section 1491, asserting that the costs incurred by it constituted a readjustment of the sale price of its products by means of a "rebate" or "allowance" within the meaning of Section 3443(a)(2) of the Internal Revenue Code of 1939 and Section 6416(b)(1) of the Internal Revenue Code of 1954. (R. 1-5.)

After filing its answer (R. 7-9), the Government filed a motion for judgment on the pleadings (R. 15). The motion was granted by a unanimous court, and taxpayer's petition was dismissed. The Court of Claims held that the costs incurred by taxpayer in discharging its obligation under its warranty constituted an expenditure to remedy a defect, not a readjustment of the sale price; that the sale price of taxpayer's products was for an article free from defects; and that the sums expended by taxpayer in order to correct defects which later appeared were spent merely in fulfillment

[1] The repairs were made by taxpayer's authorized dealers who were, in turn, reimbursed by taxpayer. (Pet. App. 4a.)

of taxpayer's obligation to deliver an article free from defects. (Pet. App. 4a-5a; R. 77-78.)

ARGUMENT

The issue presented by the decision below has received consideration only by the Court of Claims, and no conflict with a decision of any other court is or can be asserted. In the present case, as in *General Motors Corp., Frigidaire Div.* v. *United States*, 147 F. Supp. 739, the Court of Claims has held that the cost of fulfilling the customary manufacturer's warranty does not constitute a readjustment of the sale price by a "rebate" or "allowance". Prior decisions of the Court of Claims which taxpayer contends are inconsistent with the decision below involved a different issue which is not presented by this case.

1. Under Section 3403 of the Internal Revenue Code of 1939 (Appendix A, *infra*, pp. 11-12)[2] an excise tax is imposed upon the sale by manufacturers of automobiles, trucks, and parts and accessories therefor. This tax, so far as here pertinent, is measured by the sale price as that term is defined in Section 3441(a) (Appendix A, *infra*, p. 12). Section 3443(a)(2) (Appendix A, *infra*, pp. 12-13) permits a credit or refund of excise tax paid if the "price" of a taxable article is "readjusted * * * by a bona fide discount, rebate, or allowance." The amount of the tax which may be refunded or credited is that amount which is proportionate to the part of the price which is "refunded or credited" to the purchaser. It is taxpayer's position that the costs

[2] The corresponding provisions of the Internal Revenue Code of 1954 are substantially the same, and are set forth in Appendix A *infra*, p. 13.

incurred by it in remedying defects in its products constitute readjustments of the sale price by means of a "rebate or allowance." This position, as the Court of Claims has twice held, is without merit.

What is involved here is nothing more than the customary manufacturer's warranty on automotive products. Under this warranty taxpayer had an obligation to repair or correct any defects in the products sold by it which became manifest during the period specified in the warranty. In making expenditures to remedy defects, taxpayer was not making any readjustment of the sale price but was merely fulfilling its own contractual duty and adding to the cost of the products sold. As the Court of Claims stated in *General Motors Corp., Frigidaire Div.* v. *United States*, *supra*, p. 742:

> The sales price was for an article free of defects. The cost of remedying defects that later appeared, therefore, cannot be an "allowance" to the purchaser to be deducted from the sales price. It was not an "allowance", but a sum spent to give to the purchaser what the manufacturer had represented it was selling him, to wit, a sound article.

In the decision below, the Court of Claims adhered to the same view.

The correctness of this conclusion is demonstrated by the language of the House Committee Report on the Revenue Act of 1932, in which the statutory provision in question first appeared. In that Report, it is stated. (H. Rep. No. 708, 72d Cong., 1st Sess., p. 39 (C.B. 1939-1 Cum. Bull. (Part 2) 457, 485)):

> This last provision [allowing the credit or refund] covers readjustments such as cash or

quantity discounts; credit for return of goods or containers, and any other bona fide rebate or allowance *amounting to a change in the sales price*. [Italics added.]

Clearly an expenditure made in correcting defects under a manufacturer's warranty is not a change in the sale price, but is a cost arising from the contractual obligation assumed by the manufacturer as a part of the sale.[3]

The language of the statute itself supports the conclusion that such expenditures by a manufacturer are not a readjustment of the sale price. Section 3443(a)(2) refers in terms to a refund or credit of that part of the tax which is "proportionate to the part of the price which is refunded or credited." It is manifest that in making repairs to a warranted article (or in reimbursing its purchaser for the cost of such repairs) the manufacturer has not "refunded or credited" to the purchaser any part of the sale price, but has merely placed the article in the condition in which it was warranted to be at the time of its delivery.

Essentially, taxpayer ignores the basic distinction between its contractual obligation to remove defects in the article sold and a credit or repayment of part of the sale price. The warranty here involved is in effect an agreement to repair the warranted article

[3] The applicable Regulations express the same view. Section 316.14 of Regulations 46 (Appendix A, *infra*, p. 151) provides that if an article is returned to the manufacturer under a guaranty of quality or service, a refund of tax may be made in proportion to the amount refunded to the vendee. These Regulations do not provide for any refund of tax where an article is repaired by the manufacturer and retained by the vendee.

or to reimburse the purchaser for the cost of making such repairs, if the article becomes defective within the warranty period. The sale price is fixed at the time of the original sale; it is the price established for an article wholly free from defects. If nevertheless, defects become apparent within the warranty period, the manufacturer must incur additional costs to insure that the article sold is in fact sound as originally warranted.[1]

2. Taxpayer refers to four allegedly inconsistent decisions of the Court of Claims as illustrating the need for a clarifying decision by this Court. These decisions are *General Motors Corp., Frigidaire Div.* v. *United States*, 121 F. Supp. 932, certiorari denied, 348 U.S. 942; *General Motors Corp., Frigidaire Div.* v. *United States*, 146 F. Supp. 220; *General Motors Corp., Frigidaire Div.* v. *United States*, *supra*, and the decision below. Upon examination of these decisions, it is apparent that there is no inconsistency relevant to the present controversy.

In the first two *Frigidaire* cases, the question presented to the Court of Claims involved not the usual manufacturer's warranty, but a separate charge made by the manufacturer for an additional warranty for an extended period. In those cases the manufacturer

[1] As the court below properly noted, it is immaterial that defects may have appeared after taxpayer's dealers had resold the products. Under the resale contracts, the dealers were obligated to repair any defects within the same warranty period, and taxpayer under its warranty was in turn obligated to reimburse the dealers for any costs incurred. The dealer who made the repair and was then reimbursed by taxpayer neither lost nor gained anything on account of correcting the defects. Consequently, the dealer received no rebate or allowance. (Pet. App. 5a.)

sold refrigerators (also subject to excise tax) with the customary one year manufacturer's warranty. In addition, however, the manufacturer made a separate charge of $5 for a warranty on the sealed refrigerating mechanisms for an additional period of four years. In both cases, the Court of Claims held that the separate $5 charge for the additional warranty period constituted an "allowance" under Section 3443(a)(2) of the 1939 Code.

In the third *Frigidaire* case, the same issue was again presented with respect to sales made in later years. On this occasion, the Court of Claims concluded that it had been in error in previously holding that the separate $5 charge for the extended warranty constituted an "allowance". It held, however, that this charge constituted an exclusion from the sale price under Section 3441(a) of the 1939 Code, such exclusion to be limited, however, to an amount reasonably related to the cost of making repairs during the extended warranty period.

In the third *Frigidaire* case, the manufacturer also claimed, for the first time, a refund based upon the customary manufacturer's warranty of one year. On that issue the court held as it does here that the cost of fulfilling the customary warranty does not constitute an allowance and that the manufacturer is not entitled to any credit or refund based upon such cost.

After its opinion of January 16, 1957, in the third *Frigidaire* case, the Court of Claims ordered evidence to be taken, covering, *inter alia*, the question of whether the five year warranty was customary in the trade during the years involved. Upon the evidence thus taken, the court made a finding of fact that the five year

warranty in question was customary in the trade, and on July 16, 1958 (subsequent to the filing of the petition for certiorari in the present case), it wrote an opinion holding that the price paid for these warranties was a taxable part of the purchase price of the article sold and that the taxpayer's petition should be dismissed. *General Motors Corp., Frigidaire Division,* v. *United States* (C. Cls. No. 55-56), decided July 16, 1958, not yet officially reported, reprinted in Appendix B, *infra*, pp. 16-23.

The position of the Court of Claims, as reflected in its various opinions, may be summed up as follows. Expenditures by a manufacturer to fulfill ordinary or customary warranties do not constitute a readjustment of sale price, for such expenses, when they are incurred, represent the cost of giving the purchaser what he contracted to buy—a sound article. However, a particular arrangement warranting an article for an extended period may, on particular facts, justify an exclusion from the purchase price, for what is in form a warranty of fitness may be in substance an agreement to give special service or maintenance. As to the first proposition (that involving ordinary warranties), the Court of Claims has been consistent from the beginning. The court has not been consistent, to be sure, in determining the category into which the warranty of the Frigidaire mechanism was to be fitted (which may be explained in large measure by the circumstance that the facts were fully developed only in the last phase of the case). In any event, even if lack of harmony in decisions of the Court of Claims constituted an adequate basis for invoking this Court's certiorari jurisdiction (but see *Wisniewski* v. *United States*, 353 U.S. 901, 902), there would remain for petitioner the obstacle that the only

lack of consistency has been in the disposition of a case involving a factual situation quite distinct from that presented here.

CONCLUSION

The decision below is correct and there is no conflict. The petition for a writ of certiorari should be denied.

Respectfully submitted,

J. LEE RANKIN,
Solicitor General.
CHARLES K. RICE,
Assistant Attorney General.
HARRY BAUM,
MYRON C. BAUM,
Attorneys.

JULY, 1958.

APPENDIX A

Internal Revenue Code of 1939:

SEC. 3403. TAX ON AUTOMOBILES, ETC.

There shall be imposed upon the following articles sold by the manufacturer, producer, or importer, a tax equivalent to the following percentages of the price for which so sold:

"(a) [as amended by Sec. 544(a), Revenue Act of 1941, c. 412, 55 Stat. 687, and Sec. 481(a), Revenue Act of 1951, c. 521, 65 Stat. 452] Automobile truck chassis, automobile truck bodies, automobile bus chassis, automobile bus bodies, truck and bus trailer and semitrailer chassis, truck and bus trailer and semitrailer bodies, tractors of the kind chiefly used for highway transportation in combination with a trailer or semitrailer (including in each of the above cases parts or accessories therefor sold on or in connection therewith or with the sale thereof), 8 per centum,[1] * * *

(b) [as amended by Sec. 544(a), Revenue Act of 1941, *supra*, and Sec. 481(b), Revenue Act of 1951, *supra*] *Other Chassis and Bodies, Etc.*—Other automobile chassis and bodies, chassis and bodies for trailers and semitrailers (other than house trailers) suitable for use in connection with passenger automobiles, and motorcycles (including in each case parts or accessories therefor sold on or in connection therewith or with the sale thereof), except tractors, 10 per centum,[2] * * *

(c) [as amended by Sec. 544(b), Revenue Act of 1941, *supra*, Sec. 605(c)(1), Revenue Act of 1950,

[1] Prior to the enactment of the Revenue Act of 1951, *supra*, the rate was 5 percent.

[2] Prior to the enactment of the Revenue Act of 1951, *supra*, the rate was 7 percent.

c. 994, 64 Stat. 906, and Sec. 481(c), Revenue Act of 1951, *supra*.] Parts or accessories (other than tires and inner tubes and other than radio and television receiving sets) for any of the articles enumerated in subsection (a) or (b), 8 per centum,[3] * * *

(26 U. S. C. 1952 ed., Sec. 3403)

SEC. 3441. SALE PRICE.

(a) In determining, for the purposes of this chapter, the price for which an article is sold, there shall be included any charge for coverings and containers of whatever nature, and any charge incident to placing the article in condition packed ready for shipment, but there shall be excluded the amount of tax imposed by this chapter, whether or not stated as a separate charge. A transportation, delivery, insurance, installation, or other charge (not required by the foregoing sentence to be included) shall be excluded from the price only if the amount thereof is established to the satisfaction of the Commissioner, in accordance with the regulations.

* * *

(26 U. S. C. 1952 ed., Sec. 3441)

SEC. 3443. CREDITS AND REFUNDS.

(a) A credit against tax under this chapter, or a refund, may be allowed or made—

* * * * * *

(2) to any person who has paid tax under this chapter with respect to an article, when the price on which the tax was based is readjusted by reason

[3] Prior to the enactment of the Revenue Act of 1951, *supra*, the rate was 5 percent.

of return or repossession of the article or a covering or container, or by a bona fide discount, rebate, or allowance; in the amount of that part of the tax proportionate to the part of the price which is refunded or credited.

* * * * * *

(b) Credit or refund under subsection (a) shall be allowed or made only upon compliance with regulations prescribed by the Commissioner with the approval of the Secretary.

* * * * * *

(26 U. S. C. 1952 ed., Sec. 3443.)

Internal Revenue Code of 1954:

SEC. 6416. CERTAIN TAXES ON SALES AND SERVICES.

* * * * * *

(b) *Special Cases in Which Tax Payments Considered Overpayments.*—

Under regulations prescribed by the Secretary or his delegate credit or refund, without interest, shall be made of the overpayments determined under the following paragraphs:

(1) *Price readjustments.*—

If the price of any article in respect of which a tax, based on such price, is imposed by chapter 31 or 32, is readjusted by reason of the return or repossession of the article or a covering or container, or by a bona fide discount, rebate or allowance, the part of the tax proportionate to the part of the price repaid or credited to the purchaser shall be deemed to be an overpayment.

* * * * * *

(26 U.S.C. 1952 ed., Supp. V, Sec. 6416.)

Treasury Regulations 46 (1940 ed):

SEC. 316.12. *Exclusion of charges for transportation, delivery etc., generally.*—Charges for transportation, delivery, insurance, installation, and other charges actually incurred in connection with the delivery of an article to a purchaser pursuant to a bona fide sale, are to be excluded in computing the tax.

No other additional charge may be excluded in computing the tax unless it can be shown by adequate records to the satisfaction of the Commissioner that such charge properly is not to be included as a manufacturing or selling expense, or is in no way incidental to placing the article in condition packed ready for shipment.

SEC. 316.13. *Discounts and adjustments, generally.*—Readjustments in sale price (such as allowable discounts, rebates, bonuses, etc.) can not be anticipated. The tax must be based upon the original price unless the readjustments have actually been made prior to the close of the month in which the tax upon the sale is returned. However, if the price upon which the tax was computed is subsequently readjusted, a proper credit may be taken against the tax due on a subsequent return, or an appropriate claim for refund may be filed.

Commissions to agents, or allowances, payments, or adjustments made to persons other than the manufacturer's vendee are not deductible from the sale price under any conditions for purposes of computing the tax.

SEC. 316.14. *Exchanges, etc.*—Where articles sold are returned to the manufacturer by his vendee and the original sale is entirely rescinded by refunding the entire amount paid, including tax, to the vendee, no tax is payable on the transaction and, if paid, the tax may be credited or refunded. Where taxable articles sold are returned to the manufacturer by his vendee and only a part of the original sale price is refunded or credited to his vendee, the manufacturer is entitled to a tax credit computed on the portion of the sale price he refunds or credits to his vendee.

If an article is sold under a guaranty as to its quality or service and is thereafter returned and a rebate made pursuant to the guaranty, the manufacturer may claim credit or refund of such portion of the tax originally paid in respect of the article as is proportionate to the part of the price refunded to his vendee.

Where any taxable article is returned to the manufacturer thereof by his vendee for adjustment, replacement, or exchange, under a guaranty as to quality or service, and a new article given pursuant to the guaranty, free, or at a reduced price, the tax shall be computed on the actual amount, if any, to be paid to the manufacturer for the new article.

APPENDIX B

IN THE UNITED STATES COURT OF CLAIMS

No. 55-56

(Decided July 16, 1958)

GENERAL MOTORS CORPORATION, FRIGIDAIRE DIVISION,

v.

THE UNITED STATES

OPINION

MADDEN, *Judge*, delivered the opinion of the court:

This is the latest in the succession of suits brought by this plaintiff to recover excise taxes exacted from it by the Government in connection with the plaintiff's manufacture and sale of electric refrigerators. The first of the cases is reported in 128 C. Cls. at page 465. In that opinion, which was on the merits, the plaintiff's five year warranty of the refrigerating unit in its refrigerators, the so-called "Five Year Protection Plan", is described in detail and its history is recited. The court held that the actual expense of the plaintiff's repair and replacement of these units in satisfaction of its warranty was an "allowance" within the meaning of section 3443(a)(2) of the Internal Revenue Code of 1939, and that the plaintiff could recover on that basis. Two judges, dissenting in part, would have held that the five dollar charge made by the plaintiff for the five year warranty was not a part of the price of the refrigerator and was therefore entirely exempt from the excise tax.

In the plaintiff's second case, No. 49428, decided on the merits November 7, 1956, the court's decision was the same as in the first. Chief Judge Jones and Judge Laramore concurred, but with the express statement that "recovery in such cases is and should be limited to the cost incident to a protective plan that goes beyond the customary guarantee or service applicable in the trade generally."

In the instant case the court has made a finding that the five year warranty of refrigerating units has been customary in the trade generally during the years involved in all of the plaintiff's suits. It thus becomes evident that the concurrence of Chief Judge Jones and Judge Laramore in the second case resulted from matters regarded by them as vital to the decision but about which no facts appeared of record in either the first or second case.

It will be remembered that the original *General Motors* case, decided in 1954, had not directly raised the issue of the custom in the trade as to the five year warranty. The plaintiff's brief and the court's finding 17, in that case, referred only to the fact that the one year warranty had become standardized in the refrigeration industry. While the record did not show clearly that the extended warranty for the sealed units was not adopted by the trade, the clear implication of the few references in the record is to the effect that it was not the custom in the trade generally. Therefore, the issue in the present case and the issue in the first *General Motors* case are different, both factually and legally, a matter which we will discuss more fully below.

In the plaintiff's third case, No. 55-56, decided January 16, 1957, the plaintiff sought to press the court's previous decisions to what the plaintiff insisted was their logical conclusion. It urged that the cost of fulfilling its one year warranty of all parts of its refrig-

erators should be treated as an "allowance" under section 3443(a)(2). It also made the same contentions as to its five year warranty of its refrigerating units which it had made in the earlier cases. The court rejected the plaintiff's contention as to the one year warranty, and adopted the plaintiff's original contention as to the five year warranty of the refrigerating unit. It held that the five dollars charged for the five year warranty was not a part of the price of the refrigerator and hence was not subject to the excise tax. Judge Littleton, concurring in part and dissenting in part, would have adhered to the court's first decision based on the allowance theory, because he thought that the doctrine of collateral estoppel required that decision.

The writer of this opinion dissented, taking the position that the price paid for warranties in connection with sales of refrigerators was a taxable part of the purchase price, and that the cost of fulfilling the warranties was not an "allowance" within the meaning of section 3443(a)(2). The latter position was, of course, a departure from his earlier views.

The court in the plaintiff's third case referred the case to a trial commissioner of the court to take evidence only on the question of the reasonableness of the plaintiff's five dollar charge in relation to the actual cost of fulfilling the warranty. On June 12, 1957, the trial commissioner was also ordered to take evidence on the question of whether the five year warranty was customary in the trade during the years in question.

As stated above, the court has now made a finding of fact that the five year warranty in question is customary in the trade, and has been so almost from the time that the plaintiff introduced it. The fact which was not made to appear in the earlier cases, but which the Chief Judge and Judge Laramore regarded as vital, is now a fact of record. A majority of the court is therefore of the opinion that the plaintiff is not entitled to recover

because the price paid for these warranties was a taxable part of the purchase price of the article sold.

The instant case might appear to suggest a problem of collateral estoppel. The effect of the application of the doctrine would be to set the plaintiff apart from its competitors and from all other taxpayers similarly situated. Such a doctrine of "repose" would have to have a truly compelling reason behind it.

The Supreme Court of the United States in *Commissioner v. Sunnen*, 333 U.S. 591, makes plain its view that the doctrine of collateral estoppel is to be sparingly used in tax cases. The Court said, at page 601:

> And if the very same facts and no others are involved in the second case, a case relating to a different tax year, the prior judgment will be conclusive as to the same legal issues which appear, assuming no intervening doctrinal change. But if the relevant facts in the two cases are separable, even though they may be similar or identical, collateral estoppel does not govern the legal issues which recur in the second case. Thus the second proceeding may involve an instrument or transaction identical with, but in a form separable from, the one dealt with in the first proceeding. In that situation, a court is free in the second proceeding to make an independent examination of the legal matters at issue.

As we have stated above, the issue in the original *General Motors* decision and the issue presently before the court are different. The *Sunnen* case at page 599 makes it clear that the doctrine of collateral estoppel shall only be applied when the issues remain "static, factually and legally." That is not our case.

The writer of this opinion expressed his views on the collateral estoppel question in *Engineer's Club of Philadelphia v. United States*, 95 C. Cls. 42, which was cited with apparent approval in *Sunnen*, at page 601.

The plaintiff's petition will be dismissed.

It is so ordered.

LARAMORE, *Judge*, and JONES, *Chief Judge*, concur.

LITTLETON, *Judge*, concurring:

On the occasion of the court's opinion in this case on January 16, 1957, I dissented from the holding that the charge made by the plaintiff for the contract to maintain the units after the expiration of the one year warranty was a separate charge in the nature of insurance and excludable from taxation as such under section 3441(a) of the Internal Revenue Code of 1939 so that plaintiff became entitled to recover taxes paid on the $5 charges collected from purchasers of such units. The ground of my dissent was that under the doctrine of collateral estoppel the court was bound by its decision rendered in *General Motors* v. *United States*, 128 C. Cls. 465, in which cross petitions for *certiorari* were denied by the Supreme Court on February 14, 1955, 348 U.S. 942. I was of the opinion that the doctrine of collateral estoppel was applicable because at that stage of the proceedings, i.e., on plaintiff's motion for summary judgment in the third *General Motors* case (No. 55-56), there appeared to be no change in the facts or issues from the first *General Motors* case. Upon remand to the trial commissioner of the court for hearing it was established as a fact that the extended warranty for more than one year had become a custom in the industry and was a custom in the industry during the period involved in the first *General Motors* case. This fact I believe to be most material although it was not raised nor was it a matter of record in the first or second *General Motors* cases, and I agree with Chief Judge Jones and Judge Laramore that it raises a new issue of great importance. Accordingly, since we now are faced with "points which were not at issue in the first proceeding, even though such points might have been tendered and decided at that time", I am of the opinion

that the parties are free to litigate such points in this proceeding and that the doctrine of collateral estoppel is no longer applicable. *Commissioner* v. *Sunnen*, 333 U.S. 591, 598.

Reaching the merits, I concur in the majority's opinion thereon.

WHITAKER, *Judge*, dissenting:

In my opinion, the result now reached by the majority is inconsistent with the court's opinion delivered on January 16, 1957. In that opinion we held that the $5 charge made by plaintiff for an agreement to maintain the freezing units in its refrigerators for a period of four years, in addition to the customary one-year manufacturer's warranty, was not a part of the sales price.

The case was then referred to Commissioner Akers to take proof on two things; first, whether the charge for the agreement to keep the freezing unit in repair for four years, in addition to the usual one-year warranty, was reasonable; and, second, whether in the taxable years in question it had became the custom of the trade for the manufacturer to agree to keep the freezing unit in repair for five years.

On the first question he found the charges were reasonable, and on the second he found that this was the custom of the trade. It is this latter finding that has led astray at least some of my brethren.

Notwithstanding this finding, I still think the agreement to keep the freezing units in repair for four years, in addition to the usual one-year warranty, was no part of the sales price of the refrigerator, but was something the manufacturer agreed to give the purchaser, in addition to a refrigerator free of defects from workmanship and material.

The purchaser of an article from a manufacturer is entitled to no more than a warranty that the thing sold is free of defects in material and workmanship.

In the various trades the manufacturer is accustomed to fix a limited period within which such defects are supposed to appear, which varies with the article sold. In the case of electric refrigerators, the proof in the *General Motors* case clearly shows that the customary period from the time electric refrigerators were put on the market in 1920 until 1936 was one year. The proof also shows that if something went wrong with the freezing unit after the one-year warranty period, it had to be repaired at the customer's expense. Because such repairs were frequently unsatisfactory, the General Motors in 1933 offered to its customers an agreement to make necessary repairs after the one year period for a charge of $6 per year.

Two years later, in 1935, General Motors offered its customers an agreement to keep the freezing unit in repair for a period of four years. Under the 1933 agreement this would have cost the customer $24, but General Motors reduced its price for this to $10. The following year General Motors further reduced its price to $5, for the agreement to keep the machine in repair for four years after the expiration of the one-year warranty; but, while the former agreements were optional with the purchaser, the new plan, called the "Protection Plan", was obligatory.

But, even though the purchaser was required to take and pay for this "Protection Plan", there can be no doubt that it gave the purchaser something in addition to the obligation of the manufacturer to remedy defects in material and workmanship, which had to appear within the one-year warranty period, in order to hold the manufacturer liable to make them without expense to the customer.

General Motors, being perhaps the largest manufacturer of electrical refrigerators, set the pattern for the industry, and when General Motors put into effect its

"Protection Plan", agreeing to keep the machine in repair for four additional years, whether the defects occurred from wear and tear or from any other cause, other manufacturers felt obliged to follow its example. The result was that today all manufacturers of electric refrigerators sell their machines with the agreement to keep them in repair for a period of four years, in addition to the customary one-year warranty.

But, notwithstanding the fact that this has become the custom of the trade, it is nevertheless true that this "Protection Plan", under which the manufacturer agrees to keep the machine in repair for four years in addition to the usual one-year warranty, is an agreement over and above the obligation of the manufacturer to make repairs appearing within the usual one-year warranty period, that is, repairs necessitated by defects in material and workmanship.

The usual one-year warranty was given to discharge the manufacturer's obligation to sell a sound article, free from defects in material and workmanship. He could not make a charge therefor and claim that it was not a part of the sales price, because the sales price was for a sound machine—all as more fully explained in our prior opinion. But, the manufacturer could properly make a charge for a maintenance contract, beginning after the end of the warranty period, because this was a contract to make repairs not required under its warranty that the machine it had sold was free from defects.

I think this is a proper analysis of the transaction. If it is, the $5 charge is no part of the sales price of the refrigerator, and, thus, is not subject to the excise tax.

For this reason, I dissent.

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No. 144

In the Supreme Court of the United States

OCTOBER TERM, 1958

FORD MOTOR COMPANY, *Petitioner*,

v.

THE UNITED STATES.

On Petition for a Writ of Certiorari to the United States Court of Claims.

REPLY BRIEF FOR PETITIONER

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REPLY BRIEF FOR PETITIONER

RESPONDENT'S BRIEF

The principal reason stated for granting the writ (Pet. p. 6) is:

> "1. The Court of Claims has decided an important question of federal law which has not been, but should be, settled by this Court for the guidance of manufacturers generally and for orderly administration of the Statute."

Factual analysis was set forth in support of this ground (Pet. pp. 6-7).

The Brief for the United States in Opposition, however, neither has made specific response to this ground nor answered the analysis.

A further reason urged for granting the writ (Pet. p. 15) was:

> "4. The decision below is erroneous and should be reviewed by this Court."

An analysis demonstrating the error in the decision below was set forth on pages 15-19 of the petition. The brief in opposition does not specifically answer this analysis. Instead, it enlarges, by restatement, the question presented and then purports to meet the enlarged question by an argument not pertinent to the narrow question presented here.

The questions presented in the petition are whether "cash payments or cash credits" made or allowed (1) pursuant to an express warranty, and (2) pursuant to a practice or policy of adjustment, in respect to defects, are price readjustments by "rebate or allowance" within the meaning of Section 3443(a)(2) of the Internal Revenue Code of 1939 and Section 6416(b)(1) of the Internal Revenue Code of 1954.

The brief of the United States in opposition, however, states a broader question (p. 2): Whether a manufacturer, "which incurred costs in fulfilling an express warranty", is entitled to a refund. So restated, the question is broad enough to include the factual situation in the *Frigidaire* case where the manufacturer merely incurred warranty costs in dealing with the *ultimate* purchaser. But the facts in this

case are, that the contract between the manufacturer and its immediate vendee is, by implication, reformed by a reduction in price to such vendee to reflect the value of the defective article.

The tax is on the manufacturer's price to its immediate vendee; the refund provision therefore relates only to allowances, rebates or adjustments made by the manufacturer to its immediate vendee. (Regulations 46, Sec. 316.13, Pet. p. 18.) Thus, it is the cash payment or cash credit by petitioner to its immediate vendee which is controlling. Hence the question presented is limited to "cash payments or cash credits" made by the petitioner to its immediate vendee.

As further grounds for granting the writ, petitioner also pointed out (Pet. p. 7) that "2. Confusion confronts manufacturers as a result of the four recent Court of Claims decisions".

The Brief in Opposition does not dispute the fact of inconsistency in the Court of Claims decisions, but merely asserts that "there is no inconsistency *relevant* to the present controversy" (emphasis supplied) (Br. p. 7).

This statement is incorrect in two respects.

First, the Government, in stating the basis for its position that inconsistencies in the *Frigidaire* decisions are not relevant here, overlooks a principal issue in the present case. The Government assumes that "What is involved here is nothing more than the *customary* manufacturer's *warranty* on automotive products," (emphasis supplied) (Br. p. 5). On this basis it contends that the *Frigidaire* cases contain no

relevant inconsistency since only a warranty broader in scope than customary was in issue in the first and second *Frigidaire* cases, and, while the third and fourth *Frigidaire* cases would permit recovery based on a warranty which is *not customary*, they held that a customary warranty will not support recovery.

Thus, even accepting the Government's view of relevancy, these cases are clearly relevant since a principal question in this case is whether petitioner's *policy*, which is entirely separate from and broader than the express warranty, is grounds for recovery.

Second, as pointed out on pages 10 and 11 of the petition, the first two *Frigidaire* cases proceeded on the legal premise that costs of fulfilling a warranty amounted to readjustments of price by means of an allowance within the refund provisions of the statutes—a position which, if it had not been reversed by the third *Frigidaire* case (Pet. p. 11) would have resulted in a decision below in favor of petitioner.

Nevertheless, reply also will be made to the specific arguments made in the Brief of the United States in Opposition.

ARGUMENT

The argument for the United States in opposition to the Petition for Certiorari is based on two assumptions (Br. p. 4): (1) "The issue presented by the decision below has received consideration only by the Court of Claims, and no conflict with a decision of any other court is or can be asserted"; and (2) "Prior decisions of the Court of Claims which taxpayer contends are inconsistent with the decision below involved a different issue which is not presented by this case".

1. The decision below, although not in conflict with any decision of another court involving the refund provision, is nevertheless in conflict with the well established common law and Uniform Sales Act concept that a readjustment of "price" results upon rebate or allowance to an immediate vendee on account of defects.

The decision below (156 F. Supp. 554, App. B to the Petition)—as the brief in opposition points out—adhered to the "same view" expressed in the third *Frigidaire* case (147 F. Supp. 739) (Br. p. 5):

> "The sales price was for an article free of defects. The cost of remedying defects that later appeared, therefore, cannot be an 'allowance' to the purchaser to be deducted from the sales price. It was not an 'allowance', but a sum spent to give to the purchaser what the manufacturer had represented it was selling him, to wit, a sound article."

On the facts there involved, the foregoing may be taken as holding, in effect, that the costs incurred by a manufacturer in a transaction with an *ultimate* purchaser cannot, as a matter of law, be deemed to be a readjustment of the price at which the manufacturer made its sale to its immediate vendee.

The decision below is both unsound and in direct conflict with the law governing sales when it is applied to the cash payments or cash credits made by the petitioner to its immediate vendees by reason of defects covered by the petitioner's warranty or policy.

Starting with the premise that the original contract "price" was for an article free of defects, the early common law developed the principle that an allowance to the immediate vendee on account of such vendee's cost of remedying a defect is, as a matter of law, a dim-

inution of the sales price by a readjustment to the value of the defective article sold. This concept was adopted in section 69(1)(a) of the Uniform Sales Act which provides that where there is a breach of warranty by the seller, the buyer may at his election "Accept or keep the goods and set up against the seller, the breach of warranty by way of recoupment or diminution or extinction of the price".

As explained in 3 Williston on Sales (Rev. Ed.) § 605, the recoupment concept involved in the Sales Act is not that of a technical set-off or counterclaim for damages. On the contrary, the theory of recoupment, in diminution of the purchase price, is that a defendant-vendee who has accepted and retained the defective article is "allowed to avoid the contract which was made and substitute in its stead a *quasi*-contractual obligation for the value of what he has received". Thus the transaction is deemed to have been changed by mutual consent from an express contract to purchase an article free from defect at the stated price to an implied contract to purchase a defective article at an adjusted price.* In section 605-a, Williston traced this concept of price readjustment back to *Mondel* v. *Steel*, 8 M.&W. 858 (1841), where the court pointed out:

> "* * * for in these cases the acceptance or non-return affords evidence of a new contract on a *quantum valebat*. * * *
>
> "* * * the rule which has been found so convenient is established: and that it is competent for the defendant, in all of those, not to set off, by a proceeding in the nature of a cross-action, the

* See in this connection, analysis on pages 15-19 of the Petition.

> amount of damages which he has sustained by breach of the contract, but simply to defend himself by showing how much less the subject-matter of the action was *worth*, by reason of the breach of contract; and to the extent he obtains * * * an *abatement of price* on that account, he must be considered as having received satisfaction for the breach of contract, and is precluded from recovery in another action to that extent * * *" (emphasis supplied)

Williston states (§ 605-a) that section 69(1)(a) of the Uniform Sales Act (of which he was the author) was "clearly intended to enact that recoupment in the narrow sense defined above is a permissible remedy for breach of warranty". Thus, when a seller sues for the purchase price of a warranted article, the stated price is deemed in law to have been reduced by abatement or allowance in an amount equal to that required to remedy or compensate for the defect in the article sold*.

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* See, e.g., such cases as:

Dushare v. Benedict, 120 U.S. 630, 643 (1887) (abatement)

Continental Jewelry Co. v. Pugh Bros., 168 Ala. 295, 53 So. 324, 326 (1910) (abatement)

Fletcher v. Ozark Packing Co., 188 F. 2d 858, 860 (8th Cir., 1951) (applying Ark. law) (recoupment or extinction)

Arcady Farms Milling Co. v. Eagle Poultry Packers, Inc., 45 Del. 389, 73 A. 2d 220 (1950) (diminution)

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J. B. Beaird Co. v. Burris Bros., Ltd., 216 La. 655, 44 So. 2d 693, 697 (1949) (reduction)

If a manufacturer, having sold on credit, were to sue for the purchase price and procure a judgment against the buyer limited to the price so diminished by recoupment to the value of the defective article sold, there could be no doubt that the manufacturer would be entitled to a refund *pro tanto* in respect of his payment of excise tax on the basis of the full contract price.

It is submitted that there should be no difference in the application of the refund provision of the statute where the readjustment to the immediate vendee has been by cash payments or cash credits pursuant to the provisions of an express warranty or policy rather than by way of recoupment in an action by the vendor for the price.

It must be presumed that the Congress, in referring to a readjustment in "price", by "rebate or allowance" in the refund provisions of the statutes, must have intended to embrace the concept of price readjustment attendant upon retention of the defective article as developed at common law and as incorporated into the Uniform Sales Act.

The interpretation by the Court of Claims of the refund sections of the statutes in a manner apparently in conflict with the basic common law concepts carried over into the Uniform Sales Act, and the court de-

Morse v. Moore, 83 Me. 473, 22 Atl. 362 (1891) (reviewing 19th century authorities)

Morrow v. Barrow Motor Co., 90 So. 2d 20, 22-23 (1956) (reduction)

Hever v. Ulmer, 281 S.W. 2d 320, 324 (1955) (recovery for real value only)

Hunter v. Finnerty, 119 Misc. 724, 197 N.Y. Supp. 215 (Ap. Term, 1st Dept. 1922)

cisions thereunder, presents a question of general importance which should be reviewed by this Court on certiorari.

2. The fourth *Frigidaire* decision highlights inconsistencies of critical importance in the present case.

The fourth *Frigidaire* case (App. B, Brief in Opposition) decided subsequent to the filing of the petition herein, throws into sharp relief the inconsistent positions largely apparent in the earlier Frigidaire opinions—taken by four judges of the Court of Claims concerning the nature and significance of customary and non-customary warranties.

The third *Frigidaire* decision had held that the five-year warranty would support recovery because it was broader in scope than the customary warranty. In the fourth *Frigidaire* decision, where it had been found as a fact that the five-year warranty was *customary* in the trade, a majority held against recovery. The positions taken by Judges Jones, Laramore, Whitaker and Madden in these two cases may be summarized as follows:*

(a) *Judges Jones and Laramore*: A warranty is "customary" if it is customary in the trade, and, *if* "*customary*", will not support recovery.

(b) *Judge Whitaker*: A warranty is customary if co-extensive with a manufacturer's obligation to sell a sound article. His opinions in the first and third *Frigidaire* cases clearly indicate that he views the scope and duration of such obligation as roughly equivalent to the scope and duration of a warranty which would be implied by law. He believes that a warranty which is broader in

* The position of Judge Littleton does not appear with reasonable certainty.

scope than this obligation of the manufacturer will support recovery *even if such warranty were customary in the trade.*

(c) *Judge Madden*: It is immaterial whether a warranty is customary or not; neither will support recovery.

When the Government, in essence, argues that inconsistencies in the *Frigidaire* cases concerning non-customary warranties are irrelevant because "what is involved here is nothing more than the *customary* manufacturer's warranty on automotive products" (emphasis supplied) (Br. p. 5), it fails to meet the second question presented in this petition.

The second question presented (Pet. p. 2) does not involve the express warranty, but solely concerns petitioners policy, which is applicable to periods both within and beyond the "90 day or 4000 miles" period provided in petitioner's express warranty (Pet. Ct. Cl. p. 2).

A principal issue presented by this second question under the *Frigidaire* cases is whether petitioner's policy is a non-customary warranty entitling it to recovery.

The Government admits that

> "* * * a particular arrangement warranting an article for an extended period may, on particular facts, justify an exclusion from the purchase price, for what is in form a warranty of fitness may be in substance an agreement to give special service or maintenance." (Br. p. 9)

But the inconsistent positions of the judges of the Court of Claims concerning customary and non-cus-

tomary warranties, as outlined above, render most uncertain the "particular facts" on which recovery may be achieved. The confusion which confronts manufacturers in endeavoring to arrange their programs for handling possible defects in their products in order to come within the Court of Claims decisions may be illustrated with respect to petitioner's policy.

Thus, if petitioner's policy were found as a fact to be:

(a) not customary in the industry and broader in scope than the warranty implied by law, Judges Jones, Laramore and Whitaker would favor recovery while Judge Madden would not;

(b) not customary in the industry but similar in scope to a warranty implied in law, Judges Madden and Whitaker would be against recovery while Judges Jones and Laramore would favor it;

(c) customary in the industry but broader in scope than a warranty implied by law, Judge Jones, Laramore and Madden would be against recovery while Judge Whitaker would favor it (fourth *Frigidaire* case);

(d) customary in the industry and similar in scope to a warranty which would be implied by law, Judges Jones, Laramore, Whitaker and Madden would be against recovery.

But in this case (which was decided prior to the fourth *Frigidaire* case), Judge Whitaker, writing for the court, did not apply either of the foregoing tests of "customary" to plaintiff's warranty policy.

In the *Ford* case, Judge Whitaker concluded that petitioner's express warranty was customary, presum-

ably both because similar in scope to an implied warranty and customary in the industry. This conclusion was apparently based on judicial notice since no evidence on the subject of "customary" was before the Court.

Judge Whitaker then concluded that petitioner's policy was merely in liberal interpretation of its express warranty. This was apparently based on the allegation in the petition before the Court of Claims that the scope of its policy included "periods both within and beyond the periods" covered by the express warranty. While it was competent for petitioner under this allegation to prove that its policy was not "customary" and was far broader in scope than its express warranty, this possibility was never even considered by the Court in its disposition of this case by its judgment on the pleadings.

Clearly, plaintiff is entitled at minimum to a determination of whether or not its policy is "customary" in view of the majority opinion of the Court of Claims in the *Frigidaire* cases that a warranty beyond that which is customary may provide a basis for recovery*.

But before such a determination may properly be made, there must be an authoritative decision by this Court of (1) whether there should be any distinction in legal effect between "customary" and "extraordi-

* Essential to such determination is an opportunity for plaintiff to prove as a fact that its policy is not "customary". Just as Frigidaire was accorded an opportunity to prove that its five-year warranty was not "customary", so also petitioner must be accorded such opportunity. No facts necessary for application of either test of "customary" were before the Court of Claims in the present case.

nary" warranties, and if so, (2) the correct test of what constitutes "customary".

CONCLUSION

It is respectfully submitted that this writ should be granted on the grounds that the Court of Claims has (1) made an erroneous ruling on an important general question of federal law which has not been, but should be, settled by this Court; and (2) has made conflicting decisions on issues presented here which should be reviewed by the Court for the guidance of manufacturers generally and for orderly administration of the statute.

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